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Mr Jean-Paul Gauzès
President of the EFRAG Board
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Exposure Draft ED/2017/3 Prepayment Features with Negative Compensation
Proposed Amendments to IFRS 9

Dear Mr. Gauzès

We would like to take the opportunity to comment on the proposed EFRAG response to the IASB with regards to ED/2017/3 *Prepayment Features with Negative Compensation (Proposed amendments to IFRS 9)*.

Background

UBS is a global financial services firm and one of the largest providers of mortgage products and corporate loans in Switzerland, with a portfolio in excess of CHF 140 billion of loans that fall within the scope of the recently published Exposure Draft ('ED'). Therefore, this IFRS 9 amendment is of critical importance to UBS.

These loans are measured at amortized cost under IAS 39*, Financial Instruments: Recognition and Measurement* and include early repayment clauses which can give rise to "*negative compensation*". The prepayment rights are generally restricted with private mortgage borrowers only allowed to prepay if they sell their property.

Such compensation clauses are required for Swiss private mortgages as a consequence of the Swiss Unfair Competition Act and for Swiss corporate loans as a consequence of market practice.

No peer is impacted by this amendment to the same extent as UBS.

We consider that these loans should continue to be measured at amortized cost under IFRS 9 given this best represents the economic substance of our business model and these basic lending arrangements and accords with IFRS 9's principles and objective of providing *"relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows."*

We strongly support the IASB finalizing the Exposure Draft in its current form given it successfully achieves the limited exception it had agreed to provide in line with IFRS 9's effective date.

Feedback on draft EFRAG comment letter

We are glad to note that EFRAG agrees that it is worthwhile for the IASB to address the issue of financial assets with negative compensation despite the timing of this expected amendment to IFRS 9. However, we do not agree with some of the remarks made in the current draft letter. In particular, we believe that the second eligibility criteria which requires that the fair value of the prepayment feature is insignificant on initial recognition is appropriate and acceptable and also aligns with the IASB's agreement to provide a limited exception.

We do not believe any change is required at this late stage to the second criteria and do not agree with the views expressed by others that feed into the current draft EFRAG letter that including this second criteria is too restrictive, could have unintended consequences, create complex operational challenges and disruption. Proving a feature has insignificant fair value is not new with IFRS 9 already incorporating a similar requirement in B4.1.12 and is not something we should be debating at this late stage on a technical basis (we are not aware of any peer that is materially impacted by the second criteria). We have already agreed a valuation technique with our auditors and evidenced that this criteria would be satisfied for our portfolio of impacted loans.

Such comments create significant risk that the IASB may put the whole project on hold with extremely negative consequences for UBS and others. In addition, it may result in the IASB replacing the wording with something more restrictive such as a consideration of the likelihood of exercise (we understand a narrow interpretation may be applied if this was the case).

Given this risk, we strongly believe that is preferable for the IASB to finalise the amendments in the current form and would urge EFRAG to revise the comments referenced above and confirm in its coming response to the IASB strong support for the amendment and an explicit request that the amendment is made available in time for the adoption of IFRS 9 on 1 January 2018.

Please do not hesitate to contact us if you wish to discuss any of the comments made in this letter.

Regards,
UBS AG

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